

**ASSEMBLY BILL**

**No. 1888**

**Introduced by Assembly Member Nakanishi**

February 5, 2004

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An act to add Sections 17267, 17267.5, and 24343.8 to the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

LEGISLATIVE COUNSEL'S DIGEST

AB 1888, as introduced, Nakanishi. Income taxes: medical savings accounts.

The Personal Income Tax Law and Corporation Tax Law allow various deductions in computing taxable income under those laws.

This bill would also allow, subject to certain maximum amounts, a deduction of the amount deposited in any taxable year by an individual or his or her employer in a medical savings account, as defined, and would, for taxable years commencing on or after January 1, 2004, exclude from gross income any interest earned on the moneys deposited in a medical savings account. The bill would exempt from taxation withdrawals made for qualified medical expenses, including qualified long-term care services and eligible long-term care premiums.

The bill would take effect immediately as a tax levy.

Vote: majority. Appropriation: no. Fiscal committee: yes. State-mandated local program: no.

*The people of the State of California do enact as follows:*

- 1 SECTION 1. Section 17267 is added to the Revenue and  
2 Taxation Code, to read:

17267. (a) (1) For each taxable year beginning on or after January 1, 2003, there shall be allowed as a deduction an amount equal to the amount deposited by a taxpayer during the taxable year in a medical savings account, but not to exceed one thousand five hundred dollars (\$1,500) in the case of an individual, and not to exceed three thousand dollars (\$3,000) in the case of a married couple filing jointly or a head of household, subject to the limitation in paragraph (2).

(2) (A) The maximum amount that may be deducted under this section and Section 17267.5 or 24343.8, with respect to any medical savings account, shall not exceed, in the aggregate, three thousand dollars (\$3,000) per taxable year.

(B) Any individual, whose employer has contributed to the employee's medical savings account and has claimed a deduction of less than the maximum amount allowable under subparagraph (A) with respect to that contribution for the taxable year, shall be entitled to claim the deduction established in paragraph (1) for that amount deposited in the account by the individual during that taxable year that does not exceed the difference between the maximum amount established in subparagraph (A) and the amount claimed as a deduction by the taxpayer's employer.

(3) For each taxable year beginning on or after January 1, 2004, the maximum dollar amounts established in paragraphs (1) and (2) shall be adjusted annually by the percentage change in the medical care component of the Consumer Price Index for the previous calendar year. The adjusted amount determined shall be rounded off to the nearest one dollar (\$1).

(b) For purposes of this section:

(1) "Medical savings account" means a trustee or custodial account that meets all of the following requirements:

(A) Is established by an individual, or established jointly by an individual and his or her spouse, and designated as a medical savings account by the trustee or custodian.

(B) Is established for the exclusive benefit of any individual establishing the account or his or her dependents, where the written governing instrument creating the account provides for the following:

(i) All contributions to the account are required to be in cash.

(ii) The account is established to pay, pursuant to the requirements and limitations of this section, for the qualified

1 medical expenses of an individual establishing the account or his  
2 or her spouse, or their dependents.

3 (2) “Trustee or custodian” means a bank as defined by Section  
4 408(n) of the Internal Revenue Code, or any person authorized  
5 pursuant to Section 409(a) of the Internal Revenue Code, to act as  
6 the trustee or custodian of an individual retirement account.

7 (3) (A) “Qualified long-term care services” means necessary  
8 diagnostic, preventive, therapeutic, curing, treating, mitigating,  
9 and rehabilitative services, and maintenance or personal care  
10 services, which are required by a chronically ill individual, and are  
11 provided pursuant to a plan of care prescribed by a licensed health  
12 care practitioner to the extent the amount does not exceed two  
13 hundred dollars (\$200) per day.

14 (B) For each taxable year beginning on or after January 1,  
15 2004, the maximum dollar amount established in subparagraph  
16 (A) shall be adjusted annually by the percentage change in the  
17 medical care component of the Consumer Price Index for the  
18 previous calendar year. The adjusted amount determined shall be  
19 rounded off to the nearest one dollar (\$1).

20 (4) “Chronically ill individual” means any individual who has  
21 been certified by a licensed health care practitioner, within the  
22 preceding 12-month period, as being one of the following:

23 (A) Unable to perform, without substantial assistance from  
24 another individual, at least two activities of daily living for a  
25 period of at least 90 days due to a loss of functional capacity or to  
26 cognitive impairment.

27 (B) Having a level of disability similar to the level of disability  
28 described in subparagraph (A).

29 (5) “Activities of daily living” means the following:

30 (A) Eating.

31 (B) Toileting.

32 (C) Transferring.

33 (D) Bathing.

34 (E) Dressing.

35 (F) Continence.

36 (6) “Maintenance or personal care services” means any care  
37 the primary purpose of which is the provision of needed assistance  
38 with any of the disabilities as a result of which the individual is a  
39 chronically ill individual including the protection from threats to  
40 health and safety due to severe cognitive impairment.

(7) “Long-term care insurance contract” means any insurance contract if:

(A) The only insurance protection provided under the contract is coverage of qualified long-term care services.

(B) The contract does not pay or reimburse expenses incurred for services or items to the extent that the expenses are reimbursable under the federal Medicare law, or would be reimbursable but for the application of a deductible or coinsurance amount.

(C) The contract is guaranteed renewable.

(D) The contract does not provide for a cash surrender value or other money that can be paid, assigned, pledged as collateral for a loan, or borrowed.

(E) All refunds of premiums, and all policyholder dividends or similar amounts are to be applied as a reduction in future premiums, except on the death of the insured or a complete surrender or cancellation.

(8) “Eligible long-term care premiums” means the amount paid during a taxable year for any long-term care insurance contract covering an individual or the individual’s spouse.

(9) “Dependent” shall have the same meaning as that term is defined by Section 152 of the Internal Revenue Code, and “qualified medical expenses” means expenses incurred for “medical care” as defined in Section 213 of the Internal Revenue Code, except that “medical care” shall also include qualified long-term care and qualified medical care expenses, and shall also include eligible long-term care premiums.

(c) (1) Any amount withdrawn from a medical savings account shall, except as otherwise provided in this section, be included in the income of the taxpayer who is allowed the deductions authorized by subdivision (a) for the taxable year in which the payment or distribution is made, and that taxpayer’s tax for that taxable year shall be increased by an amount equal to 10 percent of the payment or distribution, unless the payment or distribution is made to pay for the qualified medical expenses of an individual that established the account or his or her spouse or dependents.

(2) For any taxable year in which withdrawals or distributions are made from a medical savings account, the taxpayer who is allowed the deduction authorized by subdivision (a) shall, if he or

1 she is required to file a return under this part, submit to the  
2 Franchise Tax Board with that return written certification from the  
3 health care provider or providers of the type of services paid for  
4 by withdrawals or distributions from the account, and an itemized  
5 listing from the health care provider or providers of the charges for  
6 each of those services.

7 (d) Upon the death of an individual who established a medical  
8 savings account, the moneys in the account shall be included in  
9 gross income for purposes of the decedent's final return unless  
10 those moneys are deposited into a new medical savings account for  
11 the benefit of the decedent's surviving spouse and his or her  
12 dependents, or if there is no surviving spouse, into a new medical  
13 savings account for the benefit of the decedent's dependent  
14 children. If an individual who established a medical savings  
15 account dies leaving neither a surviving spouse nor any dependent  
16 children, moneys in the medical savings account shall be included  
17 in gross income for purposes of the decedent's final return unless  
18 the beneficiary of that account deposits those moneys into another  
19 medical savings account established by the beneficiary.

20 (e) Notwithstanding any other provision of this part, the  
21 transfer of an establishing individual's interest in a medical  
22 savings account to his or her former spouse under a dissolution  
23 decree or under a written instrument incident to a dissolution is not  
24 to be considered a taxable transfer made by that individual as long  
25 as the transferred moneys are deposited into another medical  
26 savings account established by the former spouse.

27 (f) Only those medical expenses that are paid or incurred in  
28 excess of the amount of moneys available in a medical savings  
29 account may be claimed as an otherwise authorized deduction by  
30 any beneficiary of that account.

31 (g) The trustee or custodian of a medical savings account shall  
32 make annual calendar year reports concerning the status of the  
33 account. The report shall contain the information required in  
34 paragraph (1) and be furnished or filed in the manner and time  
35 specified in paragraph (2).

36 (1) The annual calendar year report shall contain the following  
37 information for transactions occurring during the calendar year:

38 (A) The amount of contributions.

39 (B) The amount of distributions.

40 (C) The name and address of the trustee or custodian.

1 (D) Any other information as the Franchise Tax Board may  
2 require.

3 (2) The annual report shall be furnished to the individual on  
4 whose behalf the account is established. The report shall be  
5 furnished on or before the first day of February following the  
6 calendar year for which the report is required. The Franchise Tax  
7 Board may require the annual report to be filed with the board at  
8 the time the board specifies.

9 (h) The trustee or custodian of a medical savings account shall  
10 provide a disclosure statement to the individual for whom the  
11 account is established. The disclosure statement shall contain the  
12 information and shall be in a form as may be required by the  
13 Franchise Tax Board.

14 SEC. 2. Section 17267.5 is added to the Revenue and Taxation  
15 Code, to read:

16 17267.5. (a) There shall be allowed as a deduction the  
17 amount, not to exceed three thousand dollars (\$3,000) or the  
18 maximum adjusted amount determined pursuant to paragraph (3)  
19 of subdivision (a) of Section 17267, as applicable, that is  
20 contributed by the taxpayer during the taxable year to a medical  
21 savings account, as defined in paragraph (1) of subdivision (b) of  
22 Section 17267, of an employee of the taxpayer.

23 (b) Any deduction claimed under this section shall be in lieu of  
24 any other deduction allowed by this part with respect to the amount  
25 of taxpayer's contribution.

26 SEC. 3. Section 24343.8 is added to the Revenue and Taxation  
27 Code, to read:

28 24343.8. (a) There shall be allowed as a deduction the  
29 amount, not to exceed three thousand dollars (\$3,000) or the  
30 maximum adjusted amount determined pursuant to paragraph (3)  
31 of subdivision (a) of Section 17267, as applicable, that is  
32 contributed by the taxpayer during the taxable year to a medical  
33 savings account, as defined in paragraph (2) of subdivision (b) of  
34 Section 17267, of an employee of that taxpayer.

35 (b) Any deduction claimed under this section shall be in lieu of  
36 any other deduction allowed by this part with respect to the amount  
37 of taxpayer's contribution.



1     SEC. 4. This act provides for a tax levy within the meaning of  
2     Article IV of the Constitution and shall go into immediate effect.

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